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Chapter 5: Article Four: Bank Deposits and Collections

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Article Four: Bank Deposits and Collections

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§5.1. Revisions and repeals generally. The Massachusetts Commissioners on Uniform State Laws, in their Report on the Code to the General Court of the Commonwealth in December 1956, wrote:

> Article 4 — *Bank Deposits and Collections:* The number of "items" handled by banks as a part of the bank collection process has, since 1900, grown to tremendous proportions. It has been estimated that throughout the entire country banks handle not less than 25,000,000 items every business day. This tremendous volume, moving with surprising speed and efficiency from one bank to another, within single cities and towns and between cities and towns and over state boundary lines, has built up since 1900 its own specialized body of laws applicable to the bank collection process. The Code recognizes this fact and allocates a separate article to the subject entitled "Bank Deposits and Collections." Of course in earlier recognition of this development of a special law of bank collections the American Bankers Association promulgated in 1929 a Bank Collection Code, which Code was enacted in approximately eighteen states between 1929 and 1933. However, due to certain decisions in the United States Supreme Court and the Supreme Court of Illinois, the effectiveness of this Code was restricted with the result that since the early thirties only one state, Oklahoma, in 1937, and one territory, Alaska, in 1951, has enacted the Bank Collection Code. Thus for a period of more than twenty years the ABA Bank Collection Code has not proved to be the popular medium for obtaining uniformity in the bank collection area, with the result that there is presently a distinct need for an up-to-date statute designed to produce this result. Article 4 of the Code fills this particular need.[1]

Massachusetts had never adopted the ABA Bank Collection Code; Article 4 thus breaks much new ground in this Commonwealth. Section 2 of Chapter 765, Acts of 1957, repeals G.L., c. 107, § 53, "Lia-

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§5.1. [1] House No. 130 (1957), p. 11.

bility of Banks to Depositor for Non-Payment of Checks." [2] It also repeals G.L., c. 107, § 55, "Presentment for Payment, Conditional Credit, Payment, etc., of and for Checks and Other Demand Instruments Payable By, At or Through Banks." [3]

No good purpose would be here served by attempting to duplicate the official comments of the Law Institute and Conference of Commissioners on the several sections of Article 4. These comments, taken together, form a concise text on the law and custom of banking in the United States. In this ANNUAL SURVEY there is room only for mention of some of the high spots.

§5.2. Variation by agreement; Measure of damages; Certain action constituting ordinary care. The new customer of a bank commonly finds that on signature cards, pass books, deposit slips and the like, delivered to him when he begins his relation with the bank and at later times, are printed statements defining various aspects of the obligation of the bank toward the customer. The customer, by doing business with the bank on the basis of such documents, might be considered to have accepted all their terms. Section 4-103 of the Code attempts to define the extent to which contractual provisions so arranged can limit a customer's rights or a bank's responsibility. Following a general statement that the provisions of Article 4 may be varied by agreement, there is in Subsection 1 a stated exception providing "that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure..." [1] The parties are, however, allowed to agree on "standards by which such responsibility is to be measured if such standards are not manifestly unreasonable." [2] Federal Reserve regulations and operating letters, clearing house rules, and the like are given the effect of such agreements; action pursuant to Federal Reserve regulations and operating letters constitutes ordinary care. Action or non-action consistent with clearing house rules or with a general banking usage not disapproved by Article 4 constitutes prima facie the exercise of ordinary care. Under Section 4-103 (5) the customer's measure of damages for the bank's failure to exercise ordinary care in handling an item "is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, and where there is bad faith it includes other damages, if any suffered by the party as a proximate consequence." [3]

The Supreme Judicial Court dealt with a case involving such a

[2] See UCC §4-402, "Bank's Liability to Customer for Wrongful Dishonor."

[3] See UCC §4-301, "Deferred Posting; Recovery of Payment by Return of Items; Time of Dishonor," and §4-302, "Payor Bank's Responsibility for Late Return of Item."

§5.2. [1] UCC §4-103 (1).

[2] Ibid.

[3] UCC §4-103(5).

clause in a "bank book" on November 15, 1956.[4] The plaintiff, Ruth Polonsky, brought an action against the defendant Union Federal Savings and Loan Association for the amount of a deposit which her husband had made in a joint account in the name of Ruth Polonsky and himself. At the time the account was thus opened, the teller had handed to the husband a bank book, on the inside cover of which there was printed: "This association shall not be held responsible for money paid out to any persons unlawfully presenting this book." [5] There was no evidence that any of this printed matter ever came to the attention either of the plaintiff or her husband. An impostor presented the book and a withdrawal slip on which the plaintiff's name had been forged, and so obtained the amount of the joint account from the defendant association. In the action by Ruth Polonsky, the Supreme Judicial Court held that the provision in the depositor's pass book, exculpating the association, was binding upon the plaintiff. The Court stated that the bank book constituted part of the contract by which the parties were bound and that the situation was different from that in *Kergald v. Armstrong Transfer Express Co.*[6] where the item received, a baggage check, did not "purport to be a contract." There was no evidence that the defendant association was negligent or that it acted in bad faith.

The *Polonsky* case is thus in accord with the policy of Section 4-103 of the Code. One might ask whether the defendant Union Federal Savings and Loan Association would in any event be a "bank" within the provisions of Article 4 of the Uniform Commercial Code. The Code does not seem clearly to solve this problem; Section 1-201 (4) defines "banker" as "any person engaged in the business of banking," which seems to describe a federal savings and loan association. Perhaps the question is not very important under the circumstances of the present case, where the Supreme Judicial Court has arrived, on general principles, at the same position laid down in the Uniform Commercial Code.

§5.3. Separate office of a bank. For the purpose of computing the time within which, and determining the place at or to which action may be taken or notices or orders shall be given under Article 4, a branch or separate office of a bank is treated as a separate bank.[1] Thus a stop order should be directed to the branch where the customer's account is maintained; and the effectiveness of a stop order as to time under Section 4-303 is determined by the time when such a branch receives the stop order and has a reasonable time to act on it.

§5.4. Final payment. In modern banking practice only a very small percentage of the total number of transactions is carried out by

[4] Polonsky v. Union Federal Savings and Loan Assn., 334 Mass. 697, 138 N.E.2d 115 (1956).

[5] 334 Mass. at 698, 138 N.E.2d at 116.

[6] 330 Mass. 254, 113 N.E.2d 53 (1953).

§5.3. [1] UCC §4-106.

an exchange of actual currency. "Payment" is a matter of bookkeeping; checks or other negotiable instruments passed to and fro among banks and business houses are essentially directions to make changes in the books. The process by which a check goes through a bank is a complicated one, and to determine when an item should be considered "paid" is difficult. This question is important in the law for many reasons. Two sections of the Code notably treat of this subject: Section 4-213, "Final Payment of Item by Payor Bank; When Provisional Debits and Credits Become Final; When Certain Credits Become Available for Withdrawal"; and Section 4-303, "When Items Subject to Notice, Stop-Order, Legal Process or Set-off; Order In Which Items may be Charged or Certified."

"Final payment" by a payor bank is accomplished under Section 4-213 either by the comparatively rare procedure of payment in cash; or by settlement for the item without reserving right to revoke or otherwise having such a right; or by making a provisional settlement for the item and then failing to revoke it in any manner and within any time permitted by agreement, clearing house, rule or statute or by having "completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith . . ." [1]

Similarly, knowledge, notice or stop order, or legal process, or set-off comes too late after the bank has accepted or certified the item, or paid it in cash, or settled for the item without having a right to revoke either by reservation or by statute, clearing house, rule or agreement; or become accountable for the item under Section 4-213 (1) (d); or has retained the item beyond the permitted time; [2] or has "completed the process of posting the item to the indicated account of the drawer, maker, or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item . . ." [3]

§5.5. "Security interest of collecting bank in items." A case decided by the United States District Court for the District of Massachusetts on December 14, 1956,[1] raises a question to which Section 4-208, "Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds," seems relevant. This was an action of interpleader in which an insurance company paid into court $4000, the amount of a draft issued by it in payment of a fire insurance claim. The United States intervened, claiming the full amount under a tax lien against the insured, one Andrade. Andrade had deposited the draft in the Fall River Trust Company which had given him credit and had permitted him to make withdrawals against the credit.

§5.4. [1] UCC §4-213(1) (c).
[2] UCC §4-302.
[3] Id. §4-303(d).

§5.5. [1] Agricultural Insurance Co. of Watertown, N.Y. v. Andrade, 146 F. Supp. 893 (D Mass. 1956).

The District Court held that as the draft was received by the bank for collection only, the bank was an agent of the payee, Andrade, and was not a holder even though it permitted the payee Andrade to draw against the draft,[2] and that the bank was therefore not entitled to the proceeds as against the United States. The court in arriving at this conclusion relied on the terms of the contract of deposit, set forth in the deposit slip and otherwise expressed between the parties; it included the following clause: "This bank acts only as depositor's collecting agent and assumes no responsibility beyond its exercise of due care. All items are credited subject to final payment and to receipt of proceeds of final payment in cash or solvent credits by this Bank at its own office." [3] The District Court suggests that had the bank become a holder in due course, it would have had a better right to the proceeds of the draft than the government had under its tax lien; but as the bank was not a holder, but merely the agent of the payee, the government was entitled to the entire fund.

Under the Uniform Commercial Code the opposite result would apparently be indicated. Under Section 4-201, called "Presumption and Duration of Agency Status of Collecting Banks . . . ," the Fall River Trust Company would have continued to be the agent of Andrade, "but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank such as those resulting from outstanding advances on the item and valid rights of set-off." [4] Under Section 4-208, "Security Interest of Collecting Bank . . .," the Fall River Trust Company would have had a security interest in the draft under two subsections, Subsection 1 (a), "to the extent to which credit given for the item has been withdrawn," and also (b) "in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given whether or not the credit is drawn upon and whether or not there is a right of charge-back . . ." [5]

Under Section 4-209 the bank would have given value to the extent that it had a security interest under the preceding section. As the District Court judge found that the bank had no notice of the government's claim, it would under the Code have been a holder in due course [6] and would thus have been entitled to retain the draft or its proceeds as against the government's lien.

§5.6. Customer's duty to discover and report unauthorized signature or alteration. Changes in limitations of time are always important, and this brief discussion of Article 4 may well end with an

[2] The court cited Boston-Continental National Bank v. Hub Fruit Co., 285 Mass. 187, 189 N.E. 89 (1934); Grower's Marketing Service, Inc. v. Webster & Atlas National Bank, 318 Mass. 496, 62 N.E.2d 225 (1945); Kirstein Leather Co. v. Dietrick, 86 F.2d 793 (1st Cir. 1936).

[3] 146 F. Supp. 893, 895 (D. Mass. 1956).

[4] UCC §4-201(1).

[5] Id. §4-208(1)(a), (b).

[6] Id. §3-302.

indication of certain changes of this sort. General Laws, c. 107, § 46, provides:

> §46. *Liability of Bank for Payment of Certain Negotiable Instruments, etc.* — No bank shall be liable to a depositor, or to the drawer of a bill of exchange upon the bank, for an amount charged to or collected from him on account of the payment by such bank of a negotiable instrument upon which the signature of any party is forged, or which is made, drawn, accepted or endorsed without authority, or which is materially altered; unless within one year after the return of such negotiable instrument to such depositor or drawer, he shall notify the bank in writing, by mail or otherwise, that, as the case may be, the signature of a party to the instrument is forged, or that the instrument was made, drawn, accepted or endorsed without authority, or that it has been materially altered. (1912, 277, § 1.)[1]

Treatment of the forged drawer's signature in the same way as the forged endorser's signature may be a hardship on the depositor. He is familiar with his own signature and so can distinguish it from a forgery; but he may not necessarily be familiar with the signatures of a chain of endorsers. Section 4-406 of the Code changes the law of Massachusetts by extending the time of the depositor to discover forged endorsements, from one year to three years.[2] The depositor's own unauthorized signature or any alteration on the face or back of the item must be discovered in one year. However, the customer may find his rights cut off in a much shorter time under Section 4-406 if he fails to be reasonably careful and prompt in examining a statement and returned vouchers, and if the bank can show that it lost by his negligence.[3] And respecting any second or additional forgery by the same wrongdoer the depositor has only a "reasonable period not exceeding 14 calendar days" under Subsection 2 to discover, and notify the bank of, the first unauthorized signature or alteration on a returned voucher. Without so notifying the bank, he cannot charge it with responsibility for paying after that period on another unauthorized signature or alteration by the same wrongdoer. A lack of ordinary care on the part of the bank, however, will reverse this result.[4]

§5.6. [1] G.L., c. 107, §46.

[2] UCC §4-406 (4).

[3] Several opinions of the Supreme Judicial Court state that this is already law in Massachusetts. See Grow v. Prudential Trust Co., 249 Mass. 325, 144 N.E. 93 (1924); Jordan Marsh Co. v. National Shawmut Bank, 201 Mass. 397, 87 N.E. 740, 22 L.R.A. (N.S.) 250 (1909); Murphy v. Metropolitan National Bank, 191 Mass. 159, 77 N.E. 693, 114 Am. St. Rep. 595 (1906); Dana v. National Bank of the Republic, 132 Mass. 156 (1882).

[4] UCC §4-406 (3).